BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Katter of the Appeal of)
)
EDWARD J. AND AUDREY H. COOPER)

Appearances:

For Appellants: Archibald M. Mull, Jr, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Boaru on the protest of Edward J. and Audrey H. Cooper to proposed assessments of additional personal income tax in the amounts of $862.62, $1,608.91, $2,603.62 and $3,573.64 for the years 1951, 1952, 1953 and 1954, respectively,

Appellant Edward J. Cooper (hereinafter referred to as appellant) conducted a coin machine business in the Santa Cruz area. He owned music machines, multiple-odd bingo pinball machines and miscellaneous amusement machines, The equipment was placed in some sixteen locations such as bars and restaurants. The proceeds from each machine, after exclusion of expenses claimed by the location owner in connection with the operation of the machine, were divided equally between appellant and the location owner.

The gross income reported in tax returns was the total of amounts retained from locations. Deductions were taken for depreciation, phonograph records and other business expenses. Respondent determined that appellant was renting space in the locations where his machines were placed and that all the coins deposited in the machines constituted gross income to him, Respondent also disallowed all expenses pursuant to section 17359 (now 17297) of the Revenue and Taxation Code which read:

> In computing net income, no deductions shall be allowed to any taxpayer on any of his gross income derived from illegal activities as defined in Chapters 9, 10 or 10.5 of Title 9 of Part 1 of the Penal Code of California; nor shall any deductions be allowed to any taxpayer on any of his gross income derived from any other activities which tend to promote or to further, or are connected or associated with, such illegal activities,

The evidence indicates that the operating arrangements between appellant and each location owner were the same as those considered by us in Appeal of Hall, Cal, St, Bd. of Equal., Dec. 29, 1958, 2 CCH Cal, Tax Cas. Par. 201-197, 3 P-H State & Local Tax Serv. Cal, Par. 58145. Our conclusion in Hall that the machine owner and each location owner were engaged in a joint venture in the operation of these machines is, accordingly, applicable here.

In Appeal of Advance Automatic Sales Co., Cal. St. Bd. of Equal,, Oct 9, 1962, CCH Cal, Tax Cas. Par. ____, 2 P-H State & Local Tax Serv. Cal. Par,, 13288, we held the ownership or possession of a pinball machine to be illegal under Penal Code sections 330b, 330.1, and 330.5 if the machine was predominantly a game of chance or if cash was paid to players for unplayed free games, and we also held bingo pinball machines to be predominantly games of chance,,

Three location owners testified that they made cash payouts to players of appellant's pinball machines for unplayed free games, Respondent introduced into evidence a collection report for December 3, 1951, from a location called "Aloha." This collection report shows total in machine, $136, expense, $70, net amount to divide, $66, location owner's share, $33, and appellant's share $33, We conclude that it was the general practice to pay cash to players of appellant's multiple-odd bingo pinball machines for unplayed free games. Accordingly, thisphase of appellant's business was illegal both on the ground of ownership and possession of bingo pinball machines which were predominantly games of chance and on the ground that cash was paid to winning players. Respondent was therefore correct in applying section 17359,

Appellant had both a music machine and a bingo pinball machine in almost every one of his locations, Appellant personally serviced the entire route, making collections from and repairs to the machines. There was therefore a substantial connection between the illegal operation of multiple-odd bingo pinball machines and the legal operation of the music and amusement machines and respondent was correct in disallowing all expenses of the business*

There were no records of amounts paid to winning players on the multiple-odd bingo pinball machines and respondent estimated this unrecorded amount as equal to 70 percent of the total amount deposited in such machines, This percentage was based on an estimate given to respondent's auditor in 1955 by a location owner who is now deceased. The three location owners who testified at the hearing on this appeal gave estimates of payouts ranging from 20 to 30 percent. Considering the time that elapsed from the years involved to the dates of the various estimates, and giving some weight to the previously mentioned collection' report, which indicates a payout of approximately

50 percent; we conclude that the payouts averaged 45 percent of the amounts deposited in the bingo pinball machines.

Appellant's records did not indicate a segregation of income as between pinball and music machines. Respondent's auditor estimated that two-thirdsof the recorded gross income was from multiple-odd pinball machines and that one-third was from music and miscellaneous amusement machines, This estimate was based on actual records for machines at one of the locations. This location required appellant to show the music machine income separate from the pinball machine income.

As we also held in Hall, supra, respondent's computation of gross income is presumptively correct. Respondent's segregation between pinball and other types of equipment was based on the only criteria at hand and was reasonable under the circumstances. In the absence of any evidence thatit was erroneous, the segregation must be sustained,

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Edward J. and Aucirey H. Cooper to proposed assessments of additional personal income tax in the amounts of $862.62, $1,608.91, $2,603.62 and $3,573.64 for the years 1951, 1952, 1953 and 1954, respectively, be modified in that the gross income is to be recomputed in accordance with the opinion of the board. In all other respects the action of the Franchise Tax Board is sustained.

Done at Pasadena, California, this 27th day of November, 1962, by the State Board of Equalization,

George R. Reilly, Chairman

Richard Nevins, Member

Paul R. Leake, Member

John W. Lynch, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary